

The Association of Insolvency and Restructuring Advisors (AIRA)
presents

Leading Through Crisis

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Immediate Issues

Facing a Chief Restructuring Officer

- Interface/Coordination with Board and Management in Special Situations
- Getting a Handle on Cash
- Employee Issues
- Tax Issues
- 363 Asset Sale Execution
- Getting Engaged – the “Alix Protocol”

Immediate Issues Facing a Chief Restructuring Officer

Interface/Coordination with Board and Management in Special Situations

Special Committees

- When faced with an impactful and possibly controversial decision in a distressed situation (such as a restructuring or sale), a CRO must understand how to interact with (and know when to assist counsel in advocating for the formation of) a Special Committee of the Board of Directors tasked with evaluating transactions and alternatives
- The formation of a Special Committee of independent or disinterested directors is a proactive way to avoid potential objections to a transaction by the U.S. Trustee, bankruptcy courts, creditors and other stakeholders and speed up the transaction process, and to help preserve 'business judgement rule' protection for board actions
- Situations that may call for the formation of a Special Committee include:
 - Restructuring or sale involving related parties (controlling shareholders, management, or interested directors)
 - Member(s) of the Board of Directors relationships with related parties that could result in the questioning the directors' intentions/motivations
 - Conflicted directors should not participate in the Special Committee
 - Potential alternatives to the transaction will result in scrutiny raised by affected parties
 - Existence of barriers to other participants in the transaction process

Special Committees

Participants– subject to counsel instructions

- Members must be independent
- Should be comprised of at least 3 members
- Members may include existing independent directors, newly appointed or elected directors, or a mix

Requirements-subject to counsel instructions

- Special Committee should have the power and authority to review and negotiate a transaction and evaluate its alternatives
- The Special Committee should be made aware of process and terms of all potential avenues
- The Special Committee must be active in the negotiation process and should be the ultimate decision maker –sometimes mandate is to reach findings and recommendations to be given to the Board at large
- Bargaining power, as well as the ability to veto a transaction
- Access to independent financial advisors and counsel

CRO will lead across the Special Committee and the full board. Will need to respect the Special Committee mandate, and help direct traffic often in a tense and unfriendly business environment

Special Committee members may need to be coached on exigencies and the specific limitations of choice under dire circumstances, i.e. cash runway, employee, vendor and customer considerations.

Getting a Handle on Cash

Effective CROs Create Organizational Focus on Cash

Cash Culture

- Culture is departure from traditional accrual accounting and sales driven culture
- Anticipates liquidity crunch – outcomes are planned instead of being reactionary
- Identifies wasteful spending more easily
- Cash forecasts are a commitment to specific actions
- Movement away from monthly or quarterly reporting to more frequent assessments

Actions to Manage and Preserve Cash

Immediate

- Identify cash balances, cash accounts and their usage
- Restrict non-essential expenditures
- Defer capital investment

Medium term

- Focus on collection efforts
- Use leverage when dealing with non-essential vendors, customers, landlords and lessors
- Renegotiate terms with vendors or re-source non-merchandise purchases

Longer term

- Sell non-core assets
- Settle litigation matters
- Pursue refinancing efforts

Does Management / Board Have Processes In Place?

Confidence and Visibility

- Tomorrow / next week / next month / next quarter / next year
- Involvement in, and priority given to, cash flow forecasting process
- Accuracy of existing forecast methodology, if one exists

Efficiency

- Availability of “real time” information
- Consideration of cash impact in decision making
- Use of cash flow KPIs

Special Sensitivity

- Hedging needs (currency and interest rate)
- Trade credit insurance and bonding lines
- Obligatory funding of pension liabilities

Financing

- Match of financing structure and operating characteristics
- Existence of long term cash flow plan – major future needs, financing facilities, drawdown and payback

Compliance and Reporting

- SOX compliance for business controls
- IFRS 7 reporting requirements
- Finance facility undertakings

Cash Management is Critical in a CRO's Environment

Importance

- Increasing lender focus on cash and balance sheet (instead of P&L)
- Increasing regulatory compliance
- Lack of additional credit resources in distressed scenarios

Potential Advantages

- More accurate forecasting and control
- Clearer accountability beyond the CFO
- Improved working capital
- Improved financing structure
- Reduced finance cost

Prerequisites

- Support “from the top”
- Cross-functional accountability
- Implementation team with appropriate authority

Key Factors for Improving Organizational Cash Focus

Leadership

- Clear statement from senior management
- Decisions and transactions evaluated for impact on cash

Predictability and control

- Key driver analysis
- Frequent refresh of receipts and payments forecasting
- Management of the key levers influencing receipts/disbursements

Integration

- Inclusion of cash-based KPIs into regular management reports
- Operational review processes include cash goals and achievements
- Integrated into and consistent with business planning, accounting, and incentive processes

Teaming

- A close working relationship between existing management and CRO is important
- Combined efforts help to ensure employee “buy-in”

CROs Focus on Addressing Immediate Liquidity Crises

- *Forecast, manage and preserve liquidity*
- *Focus on working capital improvements*
- *Dispose of non-core assets*
- *Reduce immediate stress*

Cash Management

- Develop / refine cash forecasts

Inventory

- Introduce lean inventory management processes
- Perform assessment at SKU level to identify instances of overstocking / waste

A/R and A/P

- Structure employee incentives around improvements in receivables and payables metrics
- Introduce sustainable improvements to AR/AP processes

Alternative Funding

- Introduce alternative funding if appropriate
- Restructure existing capital structures, if possible

Asset Disposals

- Identify and dispose of non-core assets

Employee Issues

Personal Liability – Federal and State Law

A CRO Needs to Be Aware of Potential Personal Liability for Employee Claims:

- Federal law: D&Os may fall within definition of “employer” under FLSA and be held personally liable for:
 - Unpaid minimum wages and overtime
 - Attendant liquidated damages (doubling of wage shortfall), interest, and attorney fees
- Key FLSA inquiry: Does manager exercise control over nature and structure of employment relationship or economic control?
 - “Totality of circumstances” test
 - Company bankruptcy does not insulate individual managers from FLSA liability
- Generally, D&Os are not the employer for purposes of state law wage liabilities (base pay, overtime, vacation accrual, commissions, bonuses, severance) and thus not personally liable
 - Exceptions:
 - Disregard of corporate formalities
 - Willful failure to pay

ERISA and WARN Liability

ERISA

- Generally, D&Os cannot be held personally liable under ERISA
- BUT D&Os may be held personally liable in action under ERISA for plan benefits where they have discretionary authority or responsibility for plan administration

WARN Act

- Federal Worker Adjustment & Retraining Notification (“WARN”) Act applies only to employers: business enterprises that employ more than 100
- Courts have held Congress intended “business enterprise” to mean corporate entity and not individual
- Individual may be held liable for WARN damages under an alter-ego theory

Best Practices

- Know your real cash-out date vs. shutdown date
- Don't employ workers beyond the date you are certain you can satisfy all of their earned wages
- Explore cash-saving alternatives, including furloughs and pay cuts, to control wage exposure

Tax Issues

Section 6672

- As an officer, a CRO must be sure certain taxes are paid when due
- Many believe operating as a corporation shields their personal assets
- Federal (and most state) payroll (and excise) taxes are an exception
 - The IRS can—and almost always will—pursue the collection of unpaid income tax withholding taxes and withheld social security taxes from corporate officers, directors, stockholders, key employees, and anyone else who could possibly be held liable under IRS § 6672(a)
- Section 6672 turns business liability into personal tax liability for any person who willfully fails to collect, account or pay over tax
- Generally involves payroll taxes (FICA, Medicare, income tax) but can apply to other taxes the entity should have withheld and paid to IRS
- IRS has limited use of section 6672 to payroll and FDAP withholding
- Rationale behind section: Unpaid funds are held by responsible person in trust for IRS

Section 6672

Two basic requirements:

- Must be a responsible person (i.e., a person required to collect, truthfully account for, and pay over any tax imposed by the Internal Revenue Code) and
- Must willfully fail to collect such tax or truthfully account for and pay over such tax.

Good news: Section 6672 applies to trust fund taxes described in IRC section 7501 but not to corporation's portion of social security taxes

Bad news: Section 7501 specifically notes that penalties applicable for violations of duty to collect, withhold, and pay tax include penalties in "sections 6672 and 7202"

- Both civil and criminal penalties can be imposed

Criminal Liability

- Criminal liability under section 7202
 - Statute is broad enough to raise criminal prosecution concerns although IRS historically has not invoked it with respect to section 6672
 - “Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.” 26 U.S.C. § 7202
- Similar liabilities under state law
 - Potential responsible person liability for:
 - Collected but unremitted wage withholding, employment, sales, and excise taxes
 - Personal liability for non-trust fund taxes
 - Debt and tax liability for failure to maintain corporate charters and authority to do business

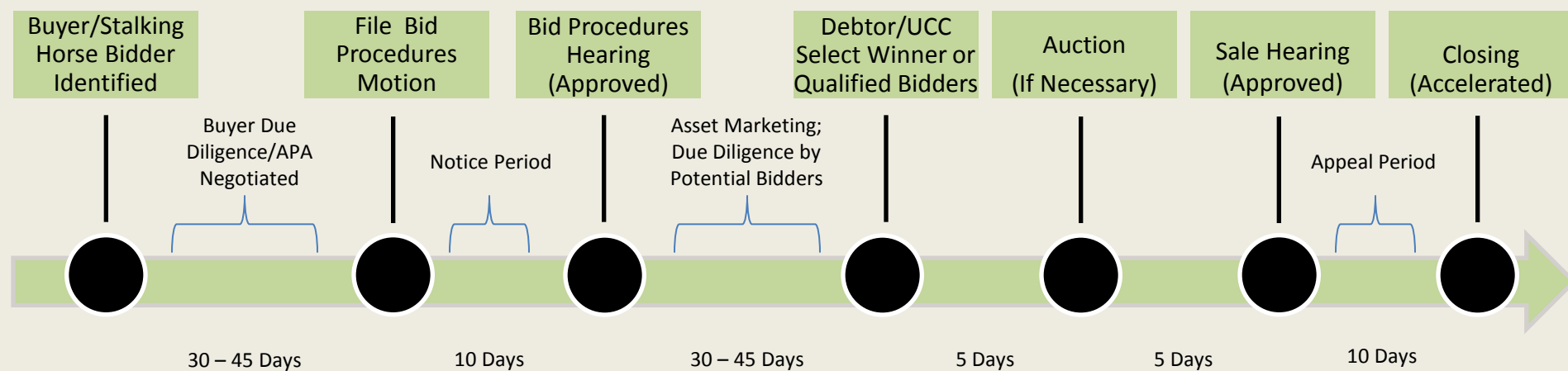
Unpaid Taxes

- Avoiding the 100% penalty
 - Understand that unpaid payroll taxes merit piercing the corporate veil and holding responsible persons liable for entire tax debt
 - Best advice – pay the taxes!
 - Consider chapter 11 filing instead of using trust fund taxes to pay other creditors
- If a responsible person discovers taxes have not been paid, immediate action is needed
 - Terminate check-signing authority
 - Resign from company
 - If resignation is not an option, refrain from attending any company meeting on finances so no inference can be drawn that responsible person preferred other creditors over IRS; willful ignorance is not a defense
- Tools to mitigate risk:
 - Outsource payroll
 - Perform periodic payroll audits
 - Obtain statements of account from the IRS to confirm payments

363 Asset Sale Execution

§ 363 Sale Process - Timing

- 363 sales typically involve only two court hearings and can typically be accomplished in 90 – 120 days



§ 363 Sale Process – Drivers of Timing

Third Party Deals

- Prepetition marketing or lack thereof
- Liquidity
- Preservation of jobs
- Established record regarding process

Insider Deals

- Investigation Period
 - Independent director/committee
 - Strong record regarding prepetition marketing process
 - Liquidity
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- Pre-petition marketing and negotiation is key to a smooth sale process
 - Limits disruption if the asset being sold is a going concern
 - Limits the cash burn
 - Speeds up the bankruptcy proceeding

§ 363 Sale Process – Digital Domain

Situation

- A storied visual special effects company founded in the 1990's by James Cameron (Titanic) grew and expanded to become a leading provider of computer generated special effects used in many well known box office blockbusters including Transformers, Tron, Ironman and many others.
- The Company, which operated in the U.S. and Canada, went public in 2011 and expanded into new business areas, including construction of a Animation Studio in Florida, an animation and VFX school offering a certified animation degree program with Florida State University and other endeavors.
- Unfortunately, the core animation business was not generating sufficient cash to support all the other businesses

Sale Process

- The Company was running out of cash and major studio clients – the Company's life blood – were threatening to pull their contracted work.
- After significant negotiation, a stalking horse bidder committed to buy the VFX production company. At the same time, the animation studio was shut down and the cash bleeding diminished.
- The Company prepared for bankruptcy and successfully ran a 9 day process, successfully resulting in competing bidders for the business.

Outcome

- In just 9 days, there was a court supervised auction for the sale of the VFX business during which five qualified bidders competed to purchase asset. A strategic buyer from Beijing, in joint venture with a major Mumbai studio, paid two times the amount of the stalking horse bid.
- Subsequently, sales of the intellectual property, real estate and other assets were organized.
- More than 500 jobs were preserved in the surviving entity.

Plan of Reorganization vs. 363 Asset Sale

Plan of Reorganization

Process

- Disclosure Statement
- Solicitation and Voting
- Confirmation

Advantages

- Liability Protections
- Other?

Disadvantages

- Complexity
- Speed (or, often, lack thereof)
- Approval of Multiple Parties Required

363 Asset Sale

Process

- Bidding Procedures Order
- Sale Process/Auction
- Sale Order

Advantages

- Speed
- Simplicity
- Free and Clear
- Assigns Leases & Contracts
- Typically No Resolution of Claims

Disadvantages

- Exposure to Auction/Competing Bids
- Risk of Attack as Sub Rosa Plan
- Typically Do Not Resolve Claims or Equity
- Credit Bid Rights May be Affected

Getting Engaged – the “Alix Protocol”

The “Alix Protocol”

- The so-called “Alix Protocol” is a guideline of the UST used in Delaware and SDNY cases.
- Often followed by other courts
- UST looking to modify and formally implement nationwide
- Purpose is to ensure that advisors wear “one hat”
- Cannot be FA and CRO
- Can be CRO and engage your firm as FA
- Special rules re: success fees

Randall S. Eisenberg is a Managing Director at AlixPartners where he co-leads the Transformation and Restructuring Advisory team, a part of the Turnaround & Restructuring Advisory Services group. He has over 20 years of experience advising senior management, board of directors, equity sponsors and credit constituents in the transformation of stagnant or underperforming companies. Randall has led many large high-profile national and international assignments, providing a broad range of services emphasizing implementation of sound business practices that focus on rebuilding shareholder and stakeholder value.

Randall's experience includes most aspects of developing and implementing transformation and turnaround plans in an out-of-court setting or through a Chapter 11 and certain other international court-supervised insolvency processes. His diverse background extends into numerous industries including airlines, automotive, healthcare, leasing, manufacturing, printing, publishing, restaurants, retail and services. He has served as an advisor to companies, served in interim management positions, advised both secured lenders and unsecured creditors, and represented interested parties in the acquisition of distressed businesses.

While many of his matters remain confidential, a selection that Randall has been involved with includes Delphi, Jackson Hewitt, Kmart, Rotech Healthcare, Select Staffing, The Children's Place, U.S. Airways Group and Visteon.

Randall is a fellow of both the American College of Bankruptcy and the International Insolvency Institute. He is the past president and chairman of the Turnaround Management Association and past president of the association of Certified Turnaround Professionals. Randall also serves as a trustee of Save The Children in the United States.

ROSEMARY GAMBARDELLA
BIOGRAPHY

Rosemary Gambardella was sworn in as a United States Bankruptcy Judge on May 3, 1985, becoming the first woman to serve on the Bankruptcy Court in the District of New Jersey. A native of Newark, Judge Gambardella attended Rutgers University where she was elected to Phi Beta Kappa and obtained a bachelor of arts degree in history in 1976. After receiving her law degree from Rutgers Law School-Newark in 1979, Judge Gambardella served as law clerk to the late Chief Bankruptcy Judge Vincent J. Commisa from 1979 to 1980. From 1980 to 1985, she was senior staff counsel to Hugh M. Leonard, then United States Trustee for the Districts of New Jersey and Delaware. Judge Gambardella served as Chief Judge of the United States Bankruptcy Court for the District of New Jersey from August 12, 1998 to August 11, 2005. She is a member of the Lawyers Advisory Committee of the Bankruptcy Court for the District of New Jersey, a member and former President of the New Jersey Bankruptcy Inn of Court and a member of the Bankruptcy Committee of the Third Circuit Task Force on Equal Treatment in the Courts - Gender Commission. In addition, she is a member of the National Association of Women Judges, the National Conference of Bankruptcy Judges, the American Bankruptcy Institute, the Turnaround Management Association and former member of the Bankruptcy Judges Advisory Group for the Administrative Office of the United States Courts. Judge Gambardella was the Bankruptcy Judge representative to the Judicial Conference of the United States (2009-2011) and is a Fellow of the American College of Bankruptcy.

Debra Grassgreen Biography

Ms. Grassgreen has significant experience representing debtors, trustees, and creditors' committees in large chapter 11 cases nationwide and internationally. Ms. Grassgreen is an author and frequent speaker on various bankruptcy-related topics including the management of large and complex chapter 11 cases, the treatment of intellectual property rights in bankruptcy, issues in hi-tech bankruptcy cases, cross-border bankruptcy issues, and issues facing individual chapter 11 debtors. Ms. Grassgreen participates in the United Nations working group (UNCITRAL) that has been developing a uniform international insolvency law and materials to assist countries in the adoption and implementation of insolvency legislation. She also serves on the Advisory Committee of the American Bankruptcy Institute Commission to Study the Reform of Chapter 11.

In 2013, Ms. Grassgreen was named by the *Daily Journal* as one of the top 100 women lawyers in California. She is a fellow in the American College of Bankruptcy, a fellow of the International Insolvency Institute, and is listed in "San Francisco's Best Lawyers" by Best Lawyers in America for her work in bankruptcy and creditor-debtor rights law. She holds an AV Preeminent Peer Rating, Martindale-Hubbell's highest recognition for ethical standards and legal ability, and was recently ranked among Bankruptcy/Restructuring attorneys by Chambers USA. Every year since 2010, she has been named a "Northern California Super Lawyer" by *San Francisco Magazine*. Ms. Grassgreen is a graduate of the University of Florida, where she also received her J.D., and is admitted to practice in Florida as well as California.

Professional Affiliations

- Fellow, American College of Bankruptcy
- Board of Directors, American College of Bankruptcy Foundation (2013-2016)
- Board of Directors & Fellow, International Insolvency Institute
- Member, Advisory Committee of the American Bankruptcy Institute Commission to Study the Reform of Chapter 11
- Board of Directors, International Women's Insolvency & Restructuring Confederation ("IWIRC")(2010-)
- IWIRC Delegate to UNCITRAL
- Member, International Bar Association
- Member, American Bar Association Business Law Section Legislation Subcommittee (2000-2004)
- Member, Florida Bar Association Business Law Section Bankruptcy/UCC Committee (1992-1996)

Michael Katzenstein

Professional Affiliations

National Association of Corporate Directors

Education

B.A. in Political Science, State University of New York, Binghamton
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About

Michael Katzenstein is a senior managing director in the FTI Consulting Corporate Finance/Restructuring practice and is based in New York. Mr. Katzenstein is a seasoned restructuring and turnaround management expert, and has led multiple engagements across many industries, with concentration in traditional and new media, technology, telecommunications and subscriber based businesses.

Mr. Katzenstein has served as an advisor or business leader in dozens of restructurings and bankruptcies and has executed across virtually every media and telecom segment, including cable television operators; CLECs; RLECs; ILECs; wireless; broadcasters; enthusiast publications; newspapers; radio; production studios and other content providers; transcontinental services providers; equipment and systems manufacturers; and international carriers. In addition, he has served as chief restructuring officer (CRO) and lead executive in technology companies, including manufacturers of electro-optical and opto-mechanical components and systems.

Mr. Katzenstein has served as CRO, interim chief executive officer, chief operating officer or as on-site advisor to debtors and other parties in interest in numerous restructuring and bankruptcy engagements, including Digital Domain; Open Range; GSI Group; CTC Communications; Birch Telecom; VarTec Telecom; Pac-West Telecomm; Pacific USA; Pacific Crossing; PT Cable; Centerpoint Broadband Technologies; PR Wireless; Global Photon and OpTel. His clients also

include major financial institutions and hedge funds.

Mr. Katzenstein serves as chairman of the board of directors of Caribbean Asset Holdings, which owns and operates the cable television, ILEC and competitive wireless operations in the USVI, BVI and St. Maartin. He also served as chairman of the board of directors of RCN, a business/enterprise CLEC and broadband services provider in major U.S. markets and formerly the tenth largest US cable provider, and was a member of the executive and audit committees. He also served on the board of directors of Sun-Times Media Group, which owned and operated more than 30 newspaper titles in the greater Chicago market, and served on the audit committee and on the board of directors of GSI Group, which designs, manufactures and sells photonic based equipment and systems and precision motion control solutions and equipment.

Mr. Katzenstein also serves as post-effective liquidating trustee for the Sun-Times estate, and serves as monitor for the benefit of claimant trusts in the first St Vincent's hospital restructuring.

Mr. Katzenstein holds a B.A. in political science from the State University of New York at Binghamton and a J.D. from Boston University School of Law. He is a member of the National Association of Corporate Directors. He began his career as an M&A and securities lawyer and was a partner in a prestigious New York law firm.